JS-6

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

ROBERT G. PERRIN, et al.,

Plaintiffs,

v.

SOUTHWEST WATER CO., et al.,

Defendants.

Case No. CV 08-7844 DMG (AGRx)

ORDER RE PLAINTIFFS' MOTION TO AMEND AND DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
[DOC. ## 134, 147]

This matter is before the Court on Plaintiffs' motion for leave to file a Third Consolidated Amended Class Action Complaint and Defendants' motion for summary judgment. [Doc. ## 134, 147.]

Defendants filed their motion for summary judgment on March 28, 2014. [Doc. # 134.] On April 4, 2014, Plaintiffs filed an opposition. [Doc. # 135.] On April 11, 2014, Defendants filed a reply. [Doc. # 138.] On April 22, 2014, the Court granted Plaintiffs additional time to conduct discovery and file supplemental briefing. [Doc. # 146.] On

May 30, 2014, Plaintiffs filed a supplemental brief. [Doc. ## 159, 185.] On June 13, 2014, Defendants filed a supplemental brief. [Doc. # 172.]

On May 16, 2014, Plaintiffs filed their motion for leave to file an amended complaint. [Doc. ## 147, 181.] On May 27, 2014, Defendants filed an opposition. [Doc. # 156.] On May 30, 2014, Plaintiffs filed a reply. [Doc. ## 158, 184.]

The Court held a hearing on the motions on June 27, 2014.

Having duly considered the parties' written submissions and oral arguments, the Court now renders its decision. For the reasons set forth below, Plaintiffs' motion for leave to file an amended complaint is **DENIED** and Defendants' motion for summary judgment is **GRANTED**.

I.

FACTUAL BACKGROUND

As it must on this motion for summary judgment, the Court sets forth the material facts and views all reasonable inferences to be drawn from them in the light most favorable to Plaintiffs, the non-moving parties. The following facts are uncontroverted.[1]

Plaintiffs Joseph Yeatte and Thomas Moshier purchased Southwest Water Company ("SWWC") stock pursuant to SWWC's Dividend Reinvestment and Stock Purchase Plan ("DRIP Plan"). (Second Consolidated Amended Class Action Complaint ("SAC") ¶ 16 [Doc. # 78].) This case concerns two SWWC Registration Statements related to the DRIP Plan. The first is Amendment No. 1 to Form S-3, filed on April 5, 2005 with the United States Securities and Exchange Commission ("SEC"). (Feldman Decl. ¶ 4 [Doc. # 134-4]; *see id.*, Exh. C [Doc. # 134-7].) The second is Form S-3, filed with the SEC on April 19, 2006. (Feldman Decl. ¶ 5; *see id.*, Exh. D [Doc. # 134-8].)

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[1] While Plaintiffs contend that none of the evidence submitted by Defendants is material (*see* P. Supp. SGD at 4-8 [Doc. # 188]), the Court disagrees, as discussed more fully *infra*. Plaintiffs have not identified *any* evidence raising a genuine dispute of material fact, and therefore the facts are uncontroverted. *See* Fed. R. Civ. P. 56(e)(2) & (3).

Plaintiffs assert that the April 5, 2005 and April 19, 2006 Registration Statements incorporated by reference SWWC's Annual Reports, which contained untrue statements of material fact, omitted facts necessary to make the statements not misleading, and failed to disclose material facts in violation of Section 11 of the Securities Act of 1933. (P's Opp'n at 3-4; SAC ¶¶ 252-62.) At issue in the motion for summary judgment is whether Plaintiffs have demonstrated that they have statutory standing to bring a Section 11 claim.

Between May 10, 2005 and November 10, 2008, shares of SWWC were deposited at The Depository Trust Company ("DTC"). (Plaintiffs' Supplemental Statement of Genuine Disputes ("P. Supp. SGD") at 4, 7 [Doc. # 188].) DTC is a registered "clearing agency" within the meaning of Section 17A of the Securities Exchange Act of 1934. (P. Supp. SGD at 4); *see also Whistler Investments, Inc. v. Depository Trust & Clearing Corp.*, 539 F.3d 1159, 1163 (9th Cir. 2008). "DTC is the nation's principal securities depository."[2] *Id.*

Securities deposited at DTC are registered by a company in "street name"—that is, the name of DTC's nominee, Cede & Co. (P. Supp. SGD at 5); *Apache Corp. v. Chevedden*, 696 F. Supp. 2d 723, 72-26 (S.D. Tex. 2010); *see also Delaware*, 507 U.S. at 495. Thus, Cede & Co., and not the shares' beneficial owner,[3] appears on the issuer's stock records as the registered owner of the shares. *See generally* John C. Wilcox, *et al.*, "Street Name" Registration & the Proxy Solicitation Process § 12.1[1] (2006 Supp.). Street name accounts allow changes in beneficial ownership to be effected through automated book entries rather than through the physical transfer of securities certificates. (P. Supp. SGD at 5); *Delaware*, 507 U.S. at 495; *see also Whistler*, 539 F.3d at 1163.

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[2] A securities depository is "a large institution that holds only the accounts of 'participant' brokers and banks and serves as a clearinghouse for its participants' securities transactions." *Delaware v. New York*, 507 U.S. 490, 496, 113 S. Ct. 1550, 123 L. Ed. 2d 211 (1993).

[3] The beneficial owners are "those investors who paid for, and have the right to vote and dispose of, the shares." John C. Wilcox, *et al.*, "Street Name" Registration & the Proxy Solicitation Process § 12.1[1] (2006 Supp.).

DTC holds deposited securities in "fungible bulk," such that its participants do not own specifically identifiable shares. (P. Supp. SGD at 5.) Rather, participants own a "pro rata interest in the aggregate number of shares of a particular issuer held at DTC." Office of Investor Education and Advocacy, Securities and Exchange Commission, "Investor Bulletin: DTC Chills and Freezes" (May 2012), *available at* www.sec.gov/tm/investor-alerts-bulletins/dtcfreezes.pdf[4]; (*see* P. Supp. SGD at 5 ("[E]ach Participant to whose DTC account securities have been credited has a proportionate interest in DTC's inventory of the issue, but none of the securities on deposit is identifiable to any particular Participant.").)

Under DTC's Fast Automated Securities Transfer ("FAST") program, the physical certificates for securities deposited at DTC are held in custody by the issuer's transfer agent. (P. Supp. SGD at 6.) Transfer agents participating in the FAST program agree to maintain DTC-eligible inventory in the form of jumbo certificates registered in the name of Cede & Co. Hensley Decl. ¶ 4 [Doc. # 134-3]; (P. Supp. SGD at 6-7). DTC and transfer agents in the FAST program electronically reconcile the results of DTC participants' daily trades. (P. Supp. SGD at 7.)

SWWC's transfer agent at all times relevant to this case was Bank of New York Mellon ("BNY Mellon"). (Kirkland Decl. ¶ 2 [Doc. # 134-5]; Keim Decl. ¶ 4 [Doc. # 134-6].) BNY Mellon participated in the FAST program on behalf of SWWC. (P. Supp. SGD at 7; Sams Decl. ¶ 7 [Doc. # 160]; *see id.*, Exh. 6 (Hensley Depo. at 32:5-19) [Doc. # 160-6].) BNY Mellon holds SWWC shares deposited at DTC in a fungible mass in a book balance. (Hensley Depo. at 18:12-20; 19:10-14; 20:3-10; 21:7-21.)

As SWWC's transfer agent, BNY Mellon "processes all stock transfer requests, produces daily stock transfer journals, maintains shareowner records and outstanding share figures, and resolves shareholder's inquiries." (Kirkland Decl. ¶ 2; Keim Decl. ¶ 3.) BNY Mellon keeps track of the daily balance with the DTC. (Hensley Depo. at 26:7-

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[4] The Court takes judicial notice of this fact. Fed. R. Evid. 201(b)(2) & (c)(1).

22.) BNY Mellon also establishes Common Stock reserves for shares to be issued pursuant to SWWC's stock plans. (Kirkland Decl. ¶ 3.) The reserves include shares from different Registration Statements, as well as unregistered shares that became freely tradable under SEC Rule 144. (*Id.*) The shares are undifferentiated and fungible. (*Id.*) BNY Mellon handled all stock transfers, including issuance of stock to shareholders participating in SWWC's DRIP Plans. (Keim Depo. at 13:3-9; 14:12-25; 15:1-2; 17:20-25; 18:1-7 [Doc. # 160].)

Prior to its issuance of the two Registration Statements at issue in this case, SWWC issued 14 Registration Statements between May 1999 and December 2004. (Keim Decl. ¶ 5; *see id.*, Exh. A; Sams Decl. ¶ 6 [Doc. # 160]; *see id.*, Exh. 5 (Keim Depo. at 16:23-25; 17:1-8) [Doc. # 160-5].)

Plaintiff Moshier used an online program called ShareBuilder and Plaintiff Yeatts used Mellon Investor Services to invest in SWWC's DRIP Program. (*See* Sams Decl. ¶ 3 [Doc. # 136]; *id.*, Exh. 1 [Doc. ## 136-1, 136-2].) The price Moshier and Yeatts paid for "newly issued shares of common stock" under the DRIP Plans was "the market price less a discount ranging from 0% to 5%, determined from time to time by [SWWC] in accordance with the Plan." (Sams Decl. ¶¶ 2, 3 [Doc. # 160]; *see id.*, Exh. 1 (April 4, 2005 Prospectus) [Doc. # 160-1]; *see id.*, Exh. 2 (April 19, 2006 Prospectus) [Doc. # 160-2].)

II.

DISCUSSION

A. Plaintiffs' Motion for Leave to File an Amended Complaint

Plaintiffs seek leave to amend their complaint to add claims for violations of Section 10(b) and Rule 10b-5 of the Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Section 20(a) of the Exchange Act.[5]

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[5] The Court's ruling on Section 11 standing, *infra*, makes futile any further amendment as to Plaintiffs' claims for violations of Section 11 and Section 15 of the Securities Act of 1933.

This Court has already dismissed with prejudice Plaintiffs' claims for violations of Section 10(b) of the Exchange Act, Rule 10b-5, and Section 20(a) of the Exchange Act [Doc. # 103], and the Court's Order was affirmed in relevant part by the Ninth Circuit [Doc. # 109]. Defendants contend that this Court lacks jurisdiction to reconsider Plaintiffs' Section 10(b) and Section 20(a) claims under the mandate doctrine. (D's Opp'n at 2-6 [Doc. # 156].) Plaintiffs respond that this issue is not controlled by the mandate doctrine, or, in the alternative, the mandate doctrine is subject to exceptions, one of which applies here. (P's Reply at 3-14 [Doc. # 184].)

The Ninth Circuit discussed the mandate doctrine in *United States v. Thrasher*:

> When a case has been once decided by this court on appeal, and remanded to the [district court], whatever was before this court, and disposed of by its decree, is considered as finally settled. The [district court] is bound by the decree as the law of the case, and must carry it into execution according to the mandate. That court cannot vary it, or examine it for any other purpose than execution; or give any other or further relief; or review it, even for apparent error, upon any matter decided on appeal; or intermeddle with it, further than to settle so much as has been remanded . . . . But the [district court] may consider and decide any matters left open by the mandate of this court. . . .

483 F.3d 977, 981 (9th Cir. 2007), *cert. denied*, 553 U.S. 1007, 128 S. Ct. 2052, 170 L. Ed. 2d 798 (2008) (quoting *In re Sanford Fork & Tool Co.*, 160 U.S. 247, 255-56, 16 S. Ct. 291, 40 L. Ed. 414 (1895) (alterations in original)). The *Thrasher* court explained that the mandate doctrine is "similar to, but broader than, the law of the case doctrine," which is a "judicial invention" pursuant to which an appellate court's decision on a legal issue must be followed in all subsequent proceedings in the same case. *Id.* at 981-82 (internal quotation omitted). The doctrines are similar in that both "serve an interest in consistency, finality and efficiency," but the mandate doctrine also "serves an interest in preserving the hierarchical structure of the court system." *Id.* at 982. In the Ninth

Circuit, the mandate doctrine is construed as jurisdictional and "if a district court errs by violating the rule of mandate, the error is a jurisdictional one." *Id.*; *see also United States v. Pimentel*, 34 F.3d 799, 800 (9th Cir. 1994) (*per curiam*) (district court was "without authority" to examine issues outside the scope of Ninth Circuit's mandate on remand).

Here, this Court explicitly dismissed Plaintiffs' Section 10(b) and Rule 10b-5 claims *with prejudice* on the ground that further amendment would be futile. (June 30, 2011 Order at 22.) The Court also dismissed Plaintiffs' Section 20(a) claim with prejudice on the ground that in order to establish control liability under Section 20(a), a plaintiff must prove a primary violation of federal securities laws, and Plaintiffs had failed to do so. (*Id.* at 23-24.)

On appeal, the Ninth Circuit affirmed the dismissal of the Section 10(b) claims upon its finding that Plaintiffs had not adequately alleged scienter. [Doc. # 109 at 5-7.] Likewise, the Ninth Circuit affirmed the dismissal of the Section 20(a) claims on the ground that such claims require a violation of Section 10(b). (*Id.* at 7.)

To the extent that Plaintiffs contend that the Ninth Circuit "did not expressly or implicitly address the possibility of amendment" (P's Reply at 5), they are incorrect. The Ninth Circuit's affirmance of this Court's Order granting Defendants' motion to dismiss necessarily entailed consideration of whether this Court properly dismissed the claims *with prejudice*. An appellate court reviews *de novo* a district court's dismissal of a complaint without leave to amend and dismissal with prejudice is "improper unless it is clear that the complaint could not be saved by any amendment." *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005) (citation omitted). Upon review of this Court's order, the Ninth Circuit held that Plaintiffs' Section 10(b) claims "d[id] not survive because the more likely inference from the facts alleged is that SouthWest was at most negligent in its failure to maintain proper accounting internal controls," and under the Private Securities Litigation Reform Act's ("PSLRA") special pleading standard, a "complaint survives a motion to dismiss only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." (*Id.* at 6-7 (internal quotation omitted).) The Ninth Circuit noted that most of the facts Plaintiffs alleged were consistent with both the fraudulent and non-fraudulent inference, but the following three facts were "consistent only with the non-fraudulent inference": (1) "the company disclosed potential problems in its accounting system during the class period"; (2) "the Confidential Witness testified that the company was making efforts to improve its accounting system"; and (3) "the accounting errors originated from distinct geographic regions." (*Id.* at 7.)

Plaintiffs' arguments against the application of the rule of mandate are unavailing. The cases they cite are all distinguishable. For example, in *Nguyen v. United States*, 792 F.2d 1500, 1503 (9th Cir. 1986), the Ninth Circuit made the unremarkable observation that the district court was free to consider a motion to amend as to *other claims*, not decided on appeal, which had been raised below. *U.S. v. Kellington*, 217 F.3d 1084 (9th Cir. 2000), is similarly inapposite. (*See* P's Reply at 3-5.) The *Kellington* court considered whether the district court exceeded its jurisdiction by reinstating the defendant's motion for a new trial after the Ninth Circuit reversed the district court's judgment of acquittal and remanded "for entry of judgment and for sentencing." 217 F.3d at 1092-95. The Ninth Circuit held that the motion for a new trial was not before it when it issued its mandate, and the motion for new trial and appeal of judgment of acquittal entailed different inquiries, and thus the mandate did not implicitly dispose of the merits of the motion for new trial. *Id.* at 1094. Thus, the Ninth Circuit held that the district court did not exceed its authority by reinstating the motion for new trial on remand. *Id.* at 1094-95.

Plaintiffs also contend that the Ninth Circuit's decision in *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. 2011), supports the notion that this Court has power to grant leave to amend the complaint even as to previously dismissed claims. In *WPP Luxembourg*, the Ninth Circuit considered whether the district court had abused its discretion when it dismissed two Rule 10b-5 claims without prejudice—rather than with prejudice. 655 F.3d at 1058. The *WPP Luxembourg* court held that the district court did not abuse its discretion, given that there was no mandatory rule and district courts "have broad discretion in deciding whether to grant leave to amend and whether to dismiss actions with or without prejudice." *Id.* at 1058-59. The Ninth Circuit then "note[d]" in *dictum* that "where some claims survive a motion to dismiss, the district court, in its discretion, has power to allow an amended complaint even with regard to claims that *it earlier dismissed*," and "[t]o some extent, the ability of a district court to revive dismissed claims should evidence come to light tempers the heightened pleading standards of the PSLRA in securities actions where claims survive against co-defendants." *Id.* at 1059 (emphasis added).

WPP Luxembourg does not control this case. As an initial matter, the language Plaintiffs rely upon is *dictum*. Moreover, the opinion refers to a situation in which the *district court* dismissed claims. There is no question that a district court has the power to allow amendment of a complaint after *it* previously has dismissed claims. Rather, the question before this Court is whether a district court has the power to allow amendment of a complaint after the *Ninth Circuit* has affirmed dismissal of such claims *with prejudice*. *WPP Luxembourg* does not address this issue.

Plaintiffs next argue that to the extent *Thrasher* holds that there are no exceptions to the mandate doctrine, contradictory Ninth Circuit authority controls. (P's Reply at 6-9.) Plaintiffs are incorrect. The case they cite—*In re Fraschilla*, 235 B.R. 449 (1999), *aff'd*, 242 F.3d 381 (9th Cir. 2000) (unpublished)—is an opinion of the *Ninth Circuit Bankruptcy Appellate Panel*, not the Ninth Circuit. It was affirmed in an unpublished Ninth Circuit opinion which cannot be cited to this Court. *See* Ninth Circuit Rule 36-3(c).

Finally, Plaintiffs contend that *Thrasher* allows exceptions to the mandate doctrine. (P's Reply at 7.) Specifically, they cite to Judge Berzon's concurring opinion in *Thrasher*. (*See id.* (quoting 483 F.3d at 983 (Berzon, J., concurring)). Plaintiffs argue that an exception to the mandate doctrine is applicable here because newly obtained discovery supports their claims. (*Id.* at 7, 12-14.)

While the Ninth Circuit does not appear to have directly addressed whether, and to what extent, changed circumstances can justify a district court's departure from the mandate doctrine, pre-*Thrasher* authority suggests that departures are warranted in some situations—and that makes sense. For example, in a case prior to *Thrasher*, the Ninth Circuit held that a change in controlling authority justified a bankruptcy court's departure from a decision of the Ninth Circuit Bankruptcy Appellate Panel's ("BAP") mandate. *See In re Rainbow Magazine, Inc.*, 77 F.3d 278, 281-82 (9th Cir. 1996).

Plaintiffs have identified various cases from other circuits recognizing exceptions to the mandate doctrine. (P's Reply at 10-12.) Several of these circuits have held that their mandates are not jurisdictional, and thus the cases appear to be distinguishable. *See Thrasher*, 483 F.3d at 982 (noting that the First, Fifth, Tenth, and Federal Circuits had held that the mandate doctrine is not jurisdictional). At least one circuit that treats the mandate doctrine as jurisdictional has held that exceptions to the mandate rule arise in some situations, including in the criminal context "where there is substantially different evidence raised on subsequent trial." *U.S. v. Gibbs*, 626 F.3d 344, 350 n.4 (6th Cir. 2010). Secondary authority also suggests that departures from the mandate doctrine may be warranted in rare cases. *See* 18B Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice & Procedure: Jurisdiction 2d* § 4478.3, at 746-47 (2d ed. 2002) ("Some decisions recognize that a trial court may depart from the mandate to obey new law without first asking permission from the appellate court. Other changed circumstances also may justify a departure without seeking recall of the mandate, but the circumstances must be *clear and compelling*; appellate courts will be reluctant to authorize departure from the mandate if the justification presents a close question." (emphasis added) (internal citations omitted)). Plaintiffs have not identified, however, any case in which a court granted leave to amend a complaint based on new evidence after an appellate court had affirmed dismissal of the relevant claims with prejudice.

Even assuming that the Ninth Circuit would recognize a departure from its mandate in such a situation, a departure is unwarranted in this case. The PSLRA imposes a discovery stay during the pendency of any motion to dismiss. 15 U.S.C. § 78u-4(b)(3)(B). This section of the PSLRA was 'intended to prevent unnecessary imposition of discovery costs on defendants.'" *SG Cowen Securities Corp. v. U.S. Dist. Court for Northern Dist. of CA*, 189 F.3d 909, 911 (9th Cir. 1999) (quoting H.R. Conf. Rep. No. 104-369, 104th Cong. 1st Sess. at 32 (1995), *reprinted in* 1995 U.S.C.C.A.N. Sess. 731). "'Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than information produced by the defendants after the action has been filed.'" *Id.* at 912 (quoting *Medhekar v. United States Dist. Ct.*, 99 F.3d 325, 328 (9th Cir. 1996)). The Ninth Circuit has emphasized that a district court must dismiss the complaint if it fails to satisfy the PSLRA's heightened pleading standards, and the PLSRA's stay of discovery "clearly contemplates that 'discovery should be permitted in securities class actions *only after the court has sustained the legal sufficiency of the complaint*.'" *Id.* at 912-13 (quoting S. Rep. No. 104-98, at 14 (1995), *reprinted in* U.S.C.C.A.N. 693) (emphasis in original). Thus, when this Court dismissed Plaintiffs' Section 10(b) and Rule 10b-5 claims *with prejudice* in June 2011, it did so because it found that further amendment—based on the information Plaintiffs had *pre-discovery*—would be futile. The Ninth Circuit affirmed. The relevant question then, as now, is whether Plaintiffs had actual knowledge—before receiving information produced by Defendants—of a Section 10(b) violation. *See id.* at 911.

Moreover, as discussed, *supra*, in its Order affirming dismissal of Plaintiffs' Section 10(b) claims, the Ninth Circuit cited to three facts that militated toward an inference of negligence rather than scienter in this case. [Doc. # 109 at 8.] At best, Plaintiffs have challenged the validity of only one of those facts, i.e., that the accounting errors originated from distinct geographic regions. (*See* P's Reply at 13-14.) The Ninth Circuit reasoned, however, that *each* of the three facts demonstrated that "the more likely inference from the facts alleged is that SouthWest was at most negligent in its failure to maintain proper accounting internal controls." [Doc. # 109 at 7.]

In short, this case arises in a different context than the usual motion to amend under Fed. R. Civ. P. 15(a). The Court simply does not find that clear and compelling circumstances exist in this case to depart from the Ninth Circuit's mandate.

The Court **DENIES** Plaintiffs' motion for leave to file an amended complaint.

B. Defendants' Motion for Summary Judgment

1. Legal Standard

Summary judgment should be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *accord Wash. Mut. Inc. v. United States*, 636 F.3d 1207, 1216 (9th Cir. 2011). Material facts are those that may affect the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). A dispute is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. *Celotex Corp.*, 477 U.S. at 323. Once the moving party has met its initial burden, Rule 56(c) requires the nonmoving party to "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Id*. at 324 (quoting Fed. R. Civ. P. 56(c), (e) (1986)); *see also Norse v. City of Santa Cruz*, 629 F.3d 966, 973 (9th Cir. 2010) (*en banc*) ("Rule 56 requires the parties to set out facts they will be able to prove at trial."). "[T]he inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986).

2. Plaintiffs Lack Statutory Standing to Bring a Section 11 Claim

Defendants contend that Plaintiffs lack standing to bring a claim under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k. (D's Mot. at 9-14 [Doc. # 134-1].) Section 11 provides, in relevant part, as follows:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may . . . sue[.]

15 U.S.C. § 77k(a).

Courts have noted that Section 11 imposes strict liability for material misstatements or omissions in a stock offering's registration statement or prospectus, as it does not require a plaintiff to plead a defendant's state of mind. *See Indiana State Dist. Council of Laborers and HOD Carriers Pension and Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498, 503 (6th Cir. 2013); *Slater v. A.G. Edwards & Sons, Inc.*, 719 F.3d 1190, 1196 (10th Cir. 2013).

"While Section 11's liability provisions are expansive—creating virtually absolute liability for corporate issuers for even innocent material misstatements—its standing provisions limit putative plaintiffs to the narrow class of persons consisting of those who purchase securities that are the direct subject of the prospectus and registration statement." *Krim v. Pcorder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005) (internal citations omitted). In other words, Plaintiffs "must have purchased a security issued under that, rather than some other, registration statement." *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 (9th Cir. 1999).

The Ninth Circuit has held that a plaintiff "need not have purchased shares in the offering made under the misleading registration statement; those who purchased shares in the aftermarket have standing to sue provided they can trace their shares back to the relevant offering." *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104, 1106 (9th Cir. 2013) (citations omitted). The "tracing" requirement generally does not present an obstacle to plaintiffs when all of a company's shares have been issued in a single offering under the same registration statement. *Id.* "But when a company has issued shares under more than one registration statement, the plaintiff must prove that her shares were issued under the allegedly false or misleading registration statement, rather than some other registration statement." *Id.* (citation omitted). Where a plaintiff seeks to trace his shares to a registration statement associated with a secondary offering, he must "prove that the shares . . . purchased came from the pool of shares issued in the secondary offering, rather than from the pool of previously issued shares." *Id.* In such cases, a plaintiff can satisfy the tracing requirement in one of two ways: (1) he can prove that he purchased the shares directly in the secondary offering itself; or (2) he can prove that his shares, although purchased in the aftermarket, can be traced back to the secondary offering. *Id.*

Here, it is not clear to the Court which of the two methods Plaintiffs seek to use to prove that they can satisfy the tracing requirement. It is apparent, however, that Plaintiffs do not fit within either method. Plaintiffs have not shown that they purchased the shares at issue directly in the secondary offering. Indeed, the evidence in the record demonstrates that Plaintiffs did not buy their shares directly from the underwriters. *Id.* Moshier used an online program called ShareBuilder and Yeatts used Mellon Investor Services to invest in SWWC's DRIP Program. (*See* Sams Decl. ¶ 3 [Doc. # 136]; *id.*, Exh. 1.) Moreover, the evidence suggests that Plaintiffs did not pay the offering price. *See In re Century Aluminum*, 729 F.3d at 1106. Specifically, the April 4, 2005 and April 19, 2006 Prospectuses that Plaintiffs provided demonstrate that the price they paid for "newly issued shares of common stock" was "the market price less a discount ranging from 0% to 5%, determined from time to time by [SWWC] in accordance with the Plan." (April 4, 2005 Prospectus [Doc. # 160-1]; April 19, 2006 Prospectus [Doc. # 160-2].)

Nor have Plaintiffs demonstrated that their shares can be traced to the secondary offering. In order to demonstrate that their shares, although purchased in the aftermarket, can be traced to the secondary offering, Plaintiffs must "trace the chain of title for their shares back to the secondary offering, starting with their own purchases and ending with someone who bought directly in the secondary offering." *In re Century Aluminum*, 729 F.3d at 1106-07. Moshier and Yeatts provided evidence that they purchased their shares through ShareBuilder and Mellon Investor Services, respectively. Neither party has presented evidence of the next link in the chain of title for the shares, but presumably Mellon Investor Services and ShareBuilder are DTC participants or worked with them to purchase shares deposited at DTC in the name of Cede & Co. The uncontroverted evidence in the record establishes, however, that such shares were held in fungible mass by SWWC's transfer agent, BNY Mellon. Thus, the shares are untraceable, and Plaintiffs have not borne their burden to prove otherwise.

Plaintiffs' arguments to the contrary are unavailing. Specifically, Plaintiffs contend—based on the language of the Registration Statements at issue—that the April 4, 2005 and April 19, 2006 Prospectuses offering DRIP Plans to investors were associated with secondary offerings of SWWC shares rather than pools of previously issued shares. (*See* P. Supp. Brief at 2-7.) The language of the Registration Statements, however, does not establish the *chain of title* of the shares, the relevant question in this case. Plaintiffs' failure to trace the chain of title of their shares, "starting with their own purchases and ending with someone who bought directly in the secondary offering," is fatal to their claim. *In re Century Aluminum*, 729 F.3d at 1106-07.

Plaintiffs argue that they should not have to demonstrate chain of title because such a requirement defeats standing for all investors whose shares are held in fungible bulk. (P. Supp. Brief at 7; P's Opp'n at 17-18.) Yet, the Ninth Circuit has squarely rejected this argument:

> Courts have long noted that tracing shares in this fashion is "often impossible," because "most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares," and "many brokerage houses do not identify specific shares with particular

> accounts but instead treat the account as having an undivided interest in the house's position." *Barnes v. Osofsky*, 373 F.2d 269, 271–72 (2d Cir. 1967). Though difficult to meet in some circumstances, this tracing requirement is the condition Congress has imposed for granting access to the "relaxed liability requirements" § 11 affords. *Abbey v. Computer Memories, Inc.*, 634 F.Supp. 870, 875 (N.D. Cal. 1986); *see Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 496 (5th Cir. 2005).

In re Century Aluminum, 729 F.3d at 1107.

Accordingly, Plaintiffs have not raised a triable issue with respect to their standing to bring a Section 11 claim.[6] Defendants' motion for summary judgment is therefore **GRANTED** as to the Section 11 claim.

3. Without a Section 11 Claim, Plaintiffs' Section 15 Claim Fails

Defendants contend that Plaintiffs' Section 15 claim necessarily fails in the absence of a viable Section 11 claim. (D's Mot. at 15.)

Section 15 provides, in relevant part, as follows:

> Every person who . . . controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o.

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[6] To the extent Plaintiffs argue that their ability to trace their shares is a merits issue that must be resolved at trial (P's Opp'n at 15-16), their argument also is foreclosed by *In re Century Aluminum*. In that case, the Ninth Circuit affirmed the district court's decision granting a *motion to dismiss* the plaintiffs' Section 11 claim for failure to adequately plead facts demonstrating that the plaintiffs had statutory standing. *See* 729 F.3d at 1006-10.

Section 15 thus requires an underlying primary violation of the securities laws. *Id.*; *In re Rigel Pharmaceuticals, Inc. v. Securities Litig.*, 697 F.3d 869, 886 (9th Cir. 2012). As Plaintiffs have no remaining claim for a primary violation of the securities laws, Defendants' motion for summary judgment is **GRANTED** as to the Section 15 claim.

III.

CONCLUSION

In light of the foregoing, Plaintiffs' motion for leave to file a Third Consolidated Amended Class Action Complaint is **DENIED**. Defendants' motion for summary judgment is **GRANTED**. Plaintiffs' motion for class certification [Doc. # 121] is **DENIED** as moot.

IT IS SO ORDERED.

DATED: July 2, 2014

DOLLY M. GEE
UNITED STATES DISTRICT JUDGE